



DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE
WASHINGTON 25, D. C.

DPS-4542
COPY 1 4

#205

REPLY TO:

Auditor General
Comptroller, USAF
Hq Western District
1206 Maple Avenue (Room 916)
Los Angeles 15, California

19 September 1958

SUBJECT: Report on Price Redetermination Audit
Hycon Mfg. Company
Pasadena, California
Contract No. BC-200

TO: Contracting Officer

REF: DPS-2770

1. Purpose of Examination. An examination has been made of the contractor's proposal for price redetermination of the subject contract.

2. Scope of Audit. Manufacturing costs and general and administrative expenses for the period 1 May 1956 to 31 August 1958 were examined to establish the reasonableness of the contractor's proposed costs.

3. Results of the Examination. The contractor proposes costs of \$2,558,632, consisting of \$2,485,152 of incurred costs through 31 May 1958 and \$73,480 estimated to complete. The auditor questioned \$297,490 of the incurred costs; and, after examining the costs in the period subsequent to 31 May 1958, was of the opinion that the estimate to complete was reasonably accurate. The questioned costs are explained in the attached exhibits and are briefly stated in paragraphs 4 and 5.

4. Costs Questioned. The amounts questioned contain all related costs together with applicable general and administrative expenses.

a. Material - \$234,112. The entire amount of the Perkin-Elmer subcontract was questioned for the consideration of the Contracting Officer pending results of audit.

b. Cost Transfers:

(1) Exhibit A, Clerical Errors - \$2,957. The contractor made errors of omission in the transfer of costs to Contract No. SC 21-54.

CONTAINS SENSITIVE
COMPARTMENTED INFORMATION

25X1

#205, Rept on Price Redetermination Aud, Hycon Mfg. Co., Pasadena, Calif.,
Contract No. BC-200, 19 Sept. 1958 - (cont'd)

c. Exhibit B, General and Administrative Expenses Questioned - \$60,421. The expense pools from which these costs were allocated contained items totaling \$485,502, which in our opinion are not reasonable in amount, nor necessary for the performance of the contract.

5. Auditor's Comments. The following is submitted for the information of the Contracting Officer:

a. The Project Contract Administrator informed the auditor that he considered the contract performance completed except for certain items represented in the estimate to complete.

b. The contractor is currently taking final inventories of residual materials and our examination therefore did not include review of these inventories. Final settlement of the contractor's proposal should accordingly be subject to the results of such audit.

6. Discussion with Authorized Contractor Official: Results of our examination were discussed with Mr. H. Richard Erdman, Project Contract Administrator. He reserved opinion in all areas of the audit findings.



Project Supervisor
Western District
Auditor General

25X1

6,593,394

2,500,000
2,500,000
+ 3,261,140 \$223,210.06
78 97
2,209,014
- 234,112 (+162,891)
2197,798
+ 197,802 @ 990
2395,600

2197798
19780182
2197798
4395596
2197798
263735.76
2197798
2461534

Inset # 1
 DYS-4542
 1 4

Exhibit A

Hycon Mfg. Company
Pasadena, California

Cost Reduction of Contract No. BC-200 due to
Omissions in Intercontract Transfer

Period: Fiscal Year Ended 31 January 1958

	<u>Costs Transferred</u>		<u>Additional costs to be transferred</u>
	<u>Per the contractor</u>	<u>Per the auditor</u>	
Labor	\$20,543	\$21,551	\$1,008
Burden	25,277	26,484	1,207
Material and			
Direct Charges	<u>7,196</u>	<u>7,622</u>	426
General and Admini-	<u>53,016</u>	<u>55,657</u>	
strative Expense	<u>7,926</u>	<u>8,242</u>	<u>316</u>
Total	<u>\$60,942</u>	<u>\$63,899</u>	<u>\$2,957</u>

Encl # 2
DPS- 4542
1 4

Exhibit B

Hycon Mfg. Company
Pasadena, California

Statement of General and Administrative Expenses Questioned by the Auditor
For the Period 1 February 1956 to 31 January 1958

	<u>FY ended 31 Jan 57</u> <u>Applicable to</u> <u>the Contract</u>	<u>FY ended 31 Jan 58</u> <u>Applicable to</u> <u>the Contract</u>	<u>Total</u> <u>Questioned</u>	<u>References</u> <u>Schedule B-1</u>
1. Costs Related to Leased Property	\$ 1,923	\$ 3,862	\$ 5,785	Note 1 <i>no</i>
2. Insurance	53	1,198	1,251	Note 2 <i>no</i>
3. Financial Consulting	925	3,400	4,325	Note 3 <i>no</i>
4. Public Relations	2,114	3,506	5,620	Note 4 <i>50K</i>
5. Shows, Conventions, etc.	1,201	3,807	5,008	Note 5 <i>50K</i>
6. Washington Office Expense	1,835		1,835	Note 6 <i>o</i>
7. New York Office Expense		11,104	11,104	Note 7 <i>o</i>
8. Entertainment	318	1,718	2,036	Note 8 <i>o</i>
9. Legal Services	757	947	1,704	Note 9 <i>o</i>
10. Travel Expense	2,420	1,292	3,712	Note 10 <i>20</i>
11. Airplane Expense	2,513		2,513	Note 11 <i>1/2</i>
12. Hycon Eastern	4,135	2,866	7,001	Note 12 <i>o</i>
13. Other Consulting	1,240	1,248	2,488	Note 13 <i>?</i>
14. Executive Salary	653		653	Note 14 <i>o</i>
15. Customer Relations		2,392	2,392	Note 15 <i>o ?</i>
16. Leasehold Improvements	482		482	Note 16 <i>o</i>
17. Equipment Rental		918	918	Note 17 <i>o</i>
18. Expenses of Cincinnati and Tucson Offices	<u>1,594</u>		<u>1,594</u>	Note 18 <i>o</i>
Total General and Administrative Expenses Questioned	<u>\$22,163</u>	<u>\$38,258</u>	<u>\$60,421</u>	

2810
2504
828
838
797
7877 ✓

DyS-454

Schedule B-1
Page 1 of 4 pagesHycen Mfg. Company
Pasadena, CaliforniaFootnotes to Statement of
General and Administrative Expenses Questioned by the AuditorPeriod: 1 February 1956 to 31 January 1958

- Note 1. a. Costs totaling \$42,658 comprised rental, taxes, and legal and maintenance costs of an idle leased property formerly owned by the contractor.
- b. The balance, \$2,745, represents eight months rental by the company president of a private residence in Pasadena. Expense reports indicated that this officer did not spend enough time in this area to warrant the expenditure.

Note 2. Insurance costs questioned comprise the following:

- | | |
|--|-------------------------------|
| a. Premium on a \$1,000,000 plane accident policy for the company president. The company is the beneficiary. | \$ 1,759 |
| b. Premium on business interruption policy. Profit factor portion and the portion applicable to a wholly-owned subsidiary. | 1,885 |
| c. Two months premium on a six-months life insurance policy for the executives. Details were not available. | 3,871 |
| d. Amount reclassified by the auditor from Other Income following settlement from the insurance company and write-off of a totally-wrecked company Cadillac. | <u>325</u>
<u>\$ 7,840</u> |

Note 3. Financial Consulting costs comprise the following:

- | | |
|--|----------------------------------|
| a. A 1956 fee expensed but not paid because of non-performance. | \$6,400 |
| b. Consulting fees paid to two former company executives during the same period. | 14,580 |
| c. Fees relative to company financing during the years 1956 and 1957. | <u>10,166</u>
<u>\$31,146</u> |

Schedule B-1
Page 2 of 4 pages

Hycon Mfg. Company
Pasadena, California

Footnotes to Statement of
General and Administrative Expenses Questioned by the Auditor

Period: 1 February 1956 to 31 January 1958

- Note 4. The contractor's representative informed the auditor that its public relations costs were incurred to bring the name of the company to the attention of prospective customers and investors.
- Note 5. At 13 May 1958 Navy Audit agreed to reinstate 50% of this type of questioned expenses for the fiscal year ended 31 January 1957.
- Note 6. The questioned expenses comprise the following:
- a. Travel and expenses of the two Washington, D. C. representatives \$18,434
 - b. Accrued travel expenses of a former company president. Reversed during 1957 and questioned then. 2,647
- \$21,081
- Note 7. The contractor's representative informed the auditor that he knew of no reason for the existence of this office other than because of its proximity to Wall Street and sources of new capital.
- Note 8. The contractor concurred at 10 December 1957 when Contract No. FS-99 was negotiated.
- Note 9. Represents attorney's fees in a lawsuit of strictly commercial aspect. Also fees of patent attorneys relative to proprietary items.
- Note 10. The contractor's executive group incurred approximately \$100,000 of travel expense during the two-year period ended 31 January 1958. Of this amount the company president incurred in excess of \$35,000. To a great extent, the amount questioned, \$35,592, comprises expenses which appear to be of an entertainment or personal nature. Other questioned expenses are those which appeared excessive or unnecessary.

Schedule B-1

Page 3 of 4 pages

Hycon Mfg. Company
Pasadena, California

Footnotes to Statement of
General and Administrative Expenses Questioned by the Auditor

Period: 1 February 1956 to 31 January 1958

Note 11. Repairs, modifications, and leasing of the former company president's personal airplane. Navy Audit questioned these costs in the year ended 31 January 1958, and the contractor's representatives concurred.

Note 12. The amount questioned by the auditor was \$64,800, of which \$60,000 appeared to be for financial assistance. The balance, \$4,800, represents an arbitrary reclassification by the auditor of a portion of the company president's salary.

Note 13. The questioned amounts comprise the following:

For the fiscal year ended 31 January 1957:-

a. Consultant fees of the company's former general manager at \$3,000 per month.	\$ 7,500
b. Consultant fees and expenses of the company's former board chairman, the fee portion at \$1,500 per month.	<u>6,750</u>
	<u>\$14,250</u>

Navy Audit questioned these expenses, and the contractor concurred.

For the fiscal year ended 31 January 1958:-

a. Final adjustment statement from former company financial consultant, later head of the company's now-defunct New York Office.	\$ 3,500
b. Services of an engineering firm. No detail was available as to the nature of the services.	800
c. Design work by above engineering firm. Type of work not known, although during 1956 the same firm performed services relative to modification of a building.	2,196
d. Consulting services of former engineering vice-president classified to G & A in error.	400
e. Personal services for the company president	<u>632</u>
	<u>\$7,528</u>

Schedule B-1
Page 4 of 4 pages

Hycon Mfg. Company
Pasadena, California

Footnotes to Statement of
General and Administrative Expenses Questioned by the Auditor

Period: 1 February 1956 to 31 January 1958

- Note 14. The amount questioned represents the overlapping portion only of the salary and consulting fees of the former board chairman. The contractor's representative concurred in this treatment at 10 December 1957.
- Note 15. The amount questioned represents the travel expenses and salaries of three employees, since terminated.
- a. Expense reports of two of the above employees indicated that their total effort was of a commercial nature as distinguished from other Customer Relations Dept. employees whose effort appeared to be both military and commercial and therefore allocable.
- b. The third employee, classed as Administrator, Marketing Division, appeared to perform a public relations or advertising function.
- Note 16. These costs represent the write-off of costs to set up a commercial item production line and were concurred in by the controller at 10 December 1957.
- Note 17. The amount questioned represented the excess of rental costs of office equipment over normal depreciation.
- Note 18. Operating costs of the two offices were as follows:

Cincinnati	\$ 7,871
Tucson	<u>10,444</u>
	<u>\$18,315</u>

The Cincinnati Office operation was considered commercial and Tucson primarily as a liaison office by Navy Audit.